

HOUSE No. 760

By Mr. O’Flaherty of Chelsea, petition of Eugene L. O’Flaherty relative to the Massachusetts principal and income law. The Judiciary.

The Commonwealth of Massachusetts

In the Year Two Thousand and Five.

AN ACT ESTABLISHING THE MASSACHUSETTS PRINCIPAL AND INCOME ACT.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

1 The General Laws are hereby amended by inserting after
2 chapter 203B the following chapter:—

3 Chapter 203C.

4 MASSACHUSETTS PRINCIPAL AND INCOME ACT

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67 SUBCHAPTER 1.

68 DEFINITIONS AND FIDUCIARY DUTIES

69 SECTION 101. SHORT TITLE.

70 This Act may be cited as The Massachusetts Principal and
71 Income Act.

72 SECTION 102. DEFINITIONS.

73 In this Act:

74 (1) “Accounting period” means a calendar year unless another
75 12-month period is selected by a fiduciary. The term includes a
76 portion of a calendar year or other 12-month period that begins
77 when an income interest begins or ends when an income interest
78 ends.

79 (2) “Beneficiary” includes, in the case of a decedent’s estate,
80 an heir, legatee and devisee, and, in the case of a trust, an income
81 beneficiary, a remainder beneficiary and any other dist-
82 ributee.

83 (3) “Fiduciary” means a personal representative or a trustee.
84 The term includes an executor, administrator, successor personal
85 representative, special administrator, and a person performing
86 substantially the same function.

87 (4) “Income” means money or property that a fiduciary receives
88 as current return from a principal asset. The term includes a por-
89 tion of receipts from a sale, exchange, or liquidation of a principal
90 asset, to the extent provided in Article 4.

91 (5) “Income beneficiary” means a person to whom net income
92 of a trust is or may be payable.

93 (6) “Income interest” means the right of an income beneficiary
94 to receive all or part of net income, whether the terms of the trust

95 require it to be distributed or authorize it to be distributed in the
96 trustee's discretion.

97 (7) "Mandatory income interest" means the right of an income
98 beneficiary to receive net income that the terms of the trust
99 require the fiduciary to distribute.

100 (8) "Net income" means the total receipts allocated to income
101 during an accounting period minus the disbursements made from
102 income during the period, plus or minus transfers under this Act to
103 or from income during the period.

104 (9) "Person" means an individual, corporation, business trust,
105 estate, trust, partnership, limited liability company, association,
106 joint venture, government; governmental subdivision, agency, or
107 instrumentality; public corporation, or any other legal or commer-
108 cial entity.

109 (10) "Principal" means property held in trust for distribution to
110 a remainder beneficiary when the trust terminates.

111 (11) "Remainder beneficiary" means a person entitled to
112 receive principal when an income interest ends.

113 (12) "Terms of a trust" means the manifestation of the intent of
114 a settlor or decedent with respect to the trust, expressed in a
115 manner that admits of its proof in a judicial proceeding, whether
116 by written or spoken words or by conduct.

117 (13) "Trustee" includes an original, additional, or successor
118 trustee, whether or not appointed or confirmed by a court.

119 SECTION 103. FIDUCIARY DUTIES; GENERAL PRINCI-
120 PLES.

121 (a) In allocating receipts and disbursements to or between prin-
122 cipal an income, and with respect to any matter within the scope
123 of Articles 2 and 3, a fiduciary:

124 (1) shall administer a trust or estate in accordance with the
125 terms of the trust or the will, even if there is a different provision
126 in this Act;

127 (2) may administer a trust or estate by the exercise of a discre-
128 tionary power of administration given to the fiduciary by the
129 terms of the trust or the will, even if the exercise of the power
130 produces a result different from a result required or permitted by
131 this Act;

132 (3) shall administer a trust or estate in accordance with this Act
133 if the terms of the trust or the will do not contain a different provi-

134 sion or do not give the fiduciary a discretionary power of adminis-
135 tration; and (4) shall add a receipt or charge a disbursement to
136 principal to the extent that the terms of the trust and this Act do
137 not provide a rule for allocating the receipt or disbursement to or
138 between principal and income.

139 (b) In exercising the power to adjust under Section 104(a) or a
140 discretionary power of administration regarding a matter within
141 the scope of this Act, whether granted by the terms of a trust, a
142 will, or this Act, a fiduciary shall administer a trust or estate
143 impartially, based on what is fair and reasonable to all of the bene-
144 ficiaries, except to the extent that the terms of the trust or the will
145 clearly manifest an intention that the fiduciary shall or may favor
146 one or more of the beneficiaries. A determination in accordance
147 with this Act is presumed to be fair and reasonable to all of the
148 beneficiaries.

149 SECTION 104. TRUSTEE'S POWER TO ADJUST.

150 (a) A trustee may adjust between principal and income to the
151 extent the trustee considers necessary if the trustee invests and
152 manages trust assets as a prudent investor, the terms of the trust
153 describe the amount that may or must be distributed to a benefi-
154 ciary by referring to the trust's income, and the trustee determines,
155 after applying the rules in Section 103(a), that the trustee is unable
156 to comply with Section 103(b).

157 (b) In deciding whether and to what extent to exercise the
158 power conferred by subsection (a), a trustee shall consider all fac-
159 tors relevant to the trust and its beneficiaries, including the
160 following factors to the extent they are relevant:

161 (1) the nature, purpose, and expected duration of the trust;

162 (2) the intent of the settlor;

163 (3) the identity and circumstances of the beneficiaries;

164 (4) the needs for liquidity, regularity of income, and preserva-
165 tion and appreciation of capital;

166 (5) the nature and character of the assets held in the trust; the
167 extent to which an asset is used by a beneficiary; and whether an
168 asset was purchased by the trustee or received from the settlor;

169 (6) the net amount allocated to income under the other sections
170 of this Act and the increase or decrease in the value of the prin-
171 cipal assets, which the trustee may estimate as to assets for which
172 market values are not readily available;

173 (7) whether and to what extent the terms of the trust give the
174 trustee the power to invade principal or accumulate income or
175 prohibit the trustee from invading principal or accumulating
176 income, and the extent to which the trustee has exercised a power
177 from time to time to invade principal or accumulate income;

178 (8) the actual and anticipated effect of economic conditions on
179 principal and income and effects of inflation and deflation; and

180 (9) the anticipated tax consequences of an adjustment.

181 (c) A trustee may not make an adjustment:

182 (1) that diminishes the income interest in a trust that requires
183 all of the income to be paid at least annually to a spouse and for
184 which an estate tax or gift tax marital deduction would be
185 allowed, in whole or in part, if the trustee did not have the power
186 to make the adjustment;

187 (2) that reduces the actuarial value of the income interest in a
188 trust to which a person transfers property with the intent to qualify
189 for a gift tax exclusion;

190 (3) that changes the amount payable to a beneficiary as a fixed
191 annuity or a fixed fraction of the value of the trust assets;

192 (4) from any amount that is permanently set aside for charitable
193 purposes under a will or the terms of a trust unless both income
194 and principal are so set aside;

195 (5) if possessing or exercising the power to make an adjustment
196 causes an individual to be treated as the owner of all or part of the
197 trust for income tax purposes, and the individual would not be
198 treated as the owner if the trustee did not possess the power to
199 make an adjustment;

200 (6) if possessing or exercising the power to make an adjustment
201 causes all or part of the trust assets to be included for estate tax
202 purposes in the estate of an individual who has the power to
203 remove a trustee or appoint a trustee, or both, and the assets
204 would not be included in the estate of the individual if the trustee
205 did not possess the power to make an adjustment;

206 (7) if the trustee is a beneficiary of the trust; or

207 (8) if the trustee is not a beneficiary, but the adjustment would
208 benefit the trustee directly or indirectly.

209 (d) If subsection (c)(5), (6), (7), or (8) applies to a trustee and
210 there is more than one trustee, a cotrustee to whom the provision
211 does not apply may make the adjustment unless the exercise of the

212 power by the remaining trustee or trustees is not permitted by the
213 terms of the trust.

214 (e) A trustee may release the entire power conferred by subsec-
215 tion (a) or may release only the power to adjust from income to
216 principal or the power to adjust from principal to income if the
217 trustee is uncertain about whether possessing or exercising the
218 power will cause a result described in subsection (c)(1) through
219 (6) or (c)(8) or if the trustee determines that possessing or exer-
220 cising the power will or may deprive the trust of a tax benefit or
221 impose a tax burden not described in subsection (c). The release
222 may be permanent or for a specified period, including a period
223 measured by the life of an individual.

224 (f) Terms of a trust that limit the power of a trustee to make an
225 adjustment between principal and income do not affect the appli-
226 cation of this section unless it is clear from the terms of the trust
227 that the terms are intended to deny the trustee the power of adjust-
228 ment conferred by subsection (a).

229 SECTION 105. JUDICIAL CONTROL OF DISCRE-
230 TIONARY POWERS.

231 a) A court shall not change a trustee's decision to exercise or
232 not to exercise a discretionary power conferred by this Act unless
233 it determines that the decision was an abuse of the trustee's discre-
234 tion. A court shall not determine that a trustee abused his or her
235 discretion merely because the court would have exercised the dis-
236 cretion in a different manner or would not have exercised the dis-
237 cretion.

238 (b) The decisions to which subsection (a) applies include:

239 (1) A determination under Section 104(a) of whether and to
240 what extent an amount should be transferred from principal to
241 income or income to principal.

242 (2) A determination of the factors that are relevant to the trust
243 and its beneficiaries, the extent to which they are relevant, and the
244 weight, if any, to be given to the relevant factors in deciding
245 whether and to what extent to exercise the power conferred by
246 Section 104 (a).

247 (c) If a court determines that a trustee has abused his or her dis-
248 cretion, the remedy shall be to restore the income and remainder
249 beneficiaries to the positions they would have occupied if the

trustee had not abused his or her discretion, according to the following rules:

(1) To the extent that the abuse of discretion has resulted in no distribution to a beneficiary or a distribution that is too small, the court shall require the trustee to distribute to the beneficiary an amount that the court determines will restore the beneficiary, in whole or in part, to his or her appropriate position.

(2) To the extent that the abuse of discretion has resulted in a distribution to a beneficiary that is too large, the court shall restore the beneficiaries, the trust, or both, in whole or in part to their appropriate positions by requiring the trustee to withhold an amount from one or more future distributions to the beneficiary who received the distribution that was too large or requiring that beneficiary to return some or all of the distribution to the trust.

(3) To the extent the court is unable, after applying paragraphs (1) and (2), to restore the beneficiaries, the trust, or both, to the positions they would have occupied if the trustee had not abused his or her discretion, the court may require the trustee to pay an appropriate amount from his or her own funds to one or more of the beneficiaries or the trust or both.

(d) A trustee may seek court determination as to whether a proposed exercise or non-exercise by the trustee of a discretionary power by the trustee will result in an abuse of the trustee's discretion. A beneficiary objecting to the relief sought shall have the burden of establishing that an abuse of discretion would result.

SUBCHAPTER 2.
DECEDENT'S ESTATE OR
TERMINATING INCOME INTEREST.

SECTION 201. DETERMINATION AND DISTRIBUTION OF NET INCOME.

After a decedent dies, in the case of an estate, or after an income interest in a trust ends, the following rules apply:

(1) A fiduciary of an estate or of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically given to a beneficiary under the rules in Articles 3 through 5 which apply to trustees and the rules in paragraph (5). The fiduciary shall distribute the net

287 income and net principal receipts to the beneficiary who is to
288 receive the specific property.

289 (2) A fiduciary shall determine the remaining net income of a
290 decedent's estate or a terminating income interest under the rules
291 in Articles 3 through 5 which apply to trustees and by:

292 (A) including in net income all income from property used to
293 discharge liabilities;

294 (B) paying from income or principal, in the fiduciary's discre-
295 tion, fees of attorneys, accountants, and fiduciaries; court costs
296 and other expenses of administration; and interest on death taxes,
297 but the fiduciary may pay those expenses from income of property
298 passing to a trust for which the fiduciary claims an estate tax mar-
299 ital or charitable deduction only to the extent that the payment of
300 those expenses from income will not cause the reduction or loss of
301 the deduction; and

302 (C) paying from principal all other disbursements made or
303 incurred in connection with the settlement of a decedent's estate
304 or the winding up of a terminating income interest, including
305 debts, funeral expenses, disposition of remains, family
306 allowances, and death taxes and related penalties that are appor-
307 tioned to the estate or terminating income interest by the will, the
308 terms of the trust, or applicable law.

309 (3) A fiduciary shall distribute to a beneficiary who receives a
310 pecuniary amount outright the interest on the amount, if any, pro-
311 vided by the will, the terms of the trust, or applicable law from net
312 income determined under paragraph (2) or from principal to the
313 extent that net income is insufficient. If a beneficiary is to receive
314 a pecuniary amount outright from a trust after an income interest
315 ends and no interest on the amount is provided for by the terms of
316 the trust or applicable law, the fiduciary shall distribute the
317 interest to which the beneficiary would be entitled under applic-
318 able law as if the pecuniary amount were required to be paid
319 under a will.

320 (4) A fiduciary shall distribute the net income remaining after
321 distributions required by paragraph (3) in the manner described in
322 Section 202 to all other beneficiaries, including a beneficiary who
323 receives a pecuniary amount in trust, even if the beneficiary holds
324 an unqualified power to withdraw assets from the trust or other
325 presently exercisable general power of appointment over the trust.

326 (5) A fiduciary may not reduce principal or income receipts
327 from property described in paragraph (1) because of a payment
328 described in Section 501 or 502 to the extent that the will, the
329 terms of the trust, or applicable law requires the fiduciary to make
330 the payment from assets other than the property or to the extent
331 that the fiduciary recovers or expects to recover the payment from
332 a third party. The net income and principal receipts from the
333 property are determined by including all of the amounts the fidu-
334 ciary receives or pays with respect to the property, whether those
335 amounts accrued or became due before, on, or after the date of a
336 decedent's death or an income interest's terminating event, and by
337 making a reasonable provision for amounts that the fiduciary
338 believes the estate or terminating income interest may become
339 obligated to pay after the property is distributed.

340 SECTION 202. DISTRIBUTION TO RESIDUARY AND
341 REMAINDER BENEFICIARIES.

342 (a) Each beneficiary described in Section 201(4) is entitled to
343 receive a portion of the net income equal to the beneficiary's frac-
344 tional interest in undistributed principal assets, using values as of
345 the distribution date. If a fiduciary makes more than one distribu-
346 tion of assets to beneficiaries to whom this section applies, each
347 beneficiary, including one who does not receive part of the distrib-
348 ution, is entitled, as of each distribution date, to the net income
349 the fiduciary has received after the date of death or terminating
350 event or earlier distribution date but has not distributed as of the
351 current distribution date.

352 (b) In determining a beneficiary's share of net income, the
353 following rules apply:

354 (1) The beneficiary is entitled to receive a portion of the net
355 income equal to the beneficiary's fractional interest in the undis-
356 tributed principal assets immediately before the distribution date,
357 including assets that later may be sold to meet principal obliga-
358 tions.

359 (2) The beneficiary's fractional interest in the undistributed
360 principal assets must be calculated without regard to property
361 specifically given to a beneficiary and property required to pay
362 pecuniary amounts not in trust.

363 (3) The beneficiary's fractional interest in the undistributed
364 principal assets must be calculated on the basis of the aggregate

365 value of those assets as of the distribution date without reducing
366 the value by any unpaid principal obligation.

367 (4) The distribution date for purposes of this section may be
368 the date as of which the fiduciary calculates the value of the assets
369 if that date is reasonably near the date on which assets are actually
370 distributed.

371 (c) If a fiduciary does not distribute all of the collected but
372 undistributed net income to each person as of a distribution date,
373 the fiduciary shall maintain appropriate records showing the
374 interest of each beneficiary in that net income.

375 (d) A fiduciary may apply the rules in this section, to the
376 extent that the fiduciary considers it appropriate, to net gain or
377 loss realized after the date of death or terminating event or earlier
378 distribution date from the disposition of a principal asset if this
379 section applies to the income from the asset.

380 **SUBCHAPTER 3.**
381 **APPORTIONMENT AT BEGINNING AND END**
382 **OF INCOME INTEREST.**

383 **SECTION 301. WHEN RIGHT TO INCOME BEGINS AND**
384 **ENDS.**

385 (a) An income beneficiary is entitled to net income from the
386 date on which the income interest begins. An income interest
387 begins on the date specified in the terms of the trust or, if no date
388 is specified, on the date an asset becomes subject to a trust or suc-
389 cessive income interest.

390 (b) An asset becomes subject to a trust:

391 (1) on the date it is transferred to the trust in the case of an
392 asset that is transferred to a trust during the transferor's life;

393 (2) on the day after a testator's death in the case of an asset that
394 becomes subject to a trust by reason of a will, even if there is an
395 intervening period of administration of the testator's estate; or

396 (3) on the day after an individual's death in the case of an asset
397 that is transferred to a fiduciary by a third party because of the
398 individual's death.

399 (c) An asset becomes subject to a successive income interest
400 on the day after the preceding income interest ends, as determined

401 under subsection (d), even if there is an intervening period of
402 administration to wind up the preceding income interest.

403 (d) An income interest ends on the day an income beneficiary
404 dies or another terminating event occurs, or on the last day of a
405 period during which there is no beneficiary to whom a trustee may
406 distribute income.

407 SECTION 302. APPORTIONMENT OF RECEIPTS AND
408 DISBURSEMENTS WHEN DECEDENT DIES OR INCOME
409 INTEREST BEGINS.

410 (a) A trustee shall allocate an income receipt or disbursement
411 other than one to which Section 201(1) applies to principal if its
412 due date occurs on or before the date on which a decedent dies in
413 the case of an estate or before an income interest begins in the
414 case of a trust or successive income interest.

415 (b) A trustee shall allocate an income receipt or disbursement
416 to income if its due date occurs after the date on which a decedent
417 dies or on or after an income interest begins and it is a periodic
418 due date. An income receipt or disbursement must be treated as
419 accruing from day to day if its due date is not periodic or it has no
420 due date. The portion of the receipt or disbursement accruing on
421 or before the date on which a decedent dies or before an income
422 interest begins must be allocated to principal and the balance must
423 be allocated to income.

424 (c) An item of income or an obligation is due on the date the
425 payer is required to make a payment. If a payment date is not
426 stated, there is no due date for the purposes of this Act. Distribu-
427 tions to shareholders or other owners from an entity to which
428 Section 401 applies are deemed to be due on the date fixed by the
429 entity for determining who is entitled to receive the distribution
430 or, if no date is fixed, on the declaration date for the distribution.
431 A due date is periodic for receipts or disbursements that must be
432 paid at regular intervals under a lease or an obligation to pay
433 interest or if an entity customarily makes distributions at regular
434 intervals.

435 SECTION 303. APPORTIONMENT WHEN INCOME
436 INTEREST ENDS.

437 (a) In this section, “undistributed income” means net income
438 received before the date on which an income interest ends. The
439 term does not include an item of income or expense that is due or

440 accrued or net income that has been added or is required to be
441 added to principal under the terms of the trusts.

442 (b) When a mandatory income interest ends, the trustee shall
443 pay to a mandatory income beneficiary who survives that date, or
444 the estate of a deceased mandatory income beneficiary whose
445 death causes the interest to end, the beneficiary's share of the
446 undistributed income that is not disposed of under the terms of the
447 trust unless the beneficiary has an unqualified power to revoke
448 more than five percent of the trust immediately before the income
449 interest ends. In the latter case, the undistributed income from the
450 portion of the trust that may be revoked must be added to prin-
451 cipal.

452 (c) When a trustee's obligation to pay a fixed annuity or a fixed
453 fraction of the value of the trust's assets ends, the trustee shall
454 prorate the final payment if and to the extent required by applic-
455 able law to accomplish a purpose of the trust or its settlor relating
456 to income, gift, estate, or other tax requirements.

457 **SUBCHAPTER 4.**
458 **ALLOCATION OF RECEIPTS**
459 **DURING ADMINISTRATION OF TRUST RECEIPTS**
460 **FROM ENTITIES.**

461 **SECTION 401. CHARACTER OF RECEIPTS.**

462 (a) In this section, "entity" means a corporation, partnership,
463 limited liability company, regulated investment company, real
464 estate investment trust, common trust fund, or any other organiza-
465 tion in which a trustee has an interest other than a trust or estate to
466 which Section 402 applies, a business or activity to which Section
467 403 applies, or an asset-backed security to which Section 415
468 applies.

469 (b) Except as otherwise provided in this section, a trustee shall
470 allocate to income money received from an entity.

471 (c) A trustee shall allocate the following receipts from an
472 entity to principal:

473 (1) property other than money;

474 (2) money received in one distribution or a series of related dis-
475 tributions in exchange for part or all of a trust's interest in the
476 entity;

477 (3) money received in total or partial liquidation of the entity;
478 and

479 (4) money received from an entity that is a regulated invest-
480 ment company or a real estate investment trust if the money dis-
481 tributed is a capital gain dividend for federal income tax purposes.

482 (d) A trustee may rely upon a statement made by an entity
483 about the source or character of a distribution if the statement is
484 made at or near the time of distribution by the entity's board of
485 directors or other person or group of persons authorized to exer-
486 cise powers to pay money or transfer property comparable to
487 those of a corporation's board of directors.

488 SECTION 402. DISTRIBUTION FROM TRUST OR
489 ESTATE.

490 A trustee shall allocate to income an amount received as a dis-
491 tribution of income from a trust or an estate in which the trust has
492 an interest other than a purchased interest, and shall allocate to
493 principal an amount received as a distribution of principal from
494 such a trust or estate. If a trustee purchases an interest in a trust
495 that is an investment entity, or a decedent or donor transfers an
496 interest in such a trust to a trustee, Section 401 or 415 applies to a
497 receipt from the trust.

498 SECTION 403. BUSINESS AND OTHER ACTIVITIES CON-
499 DUCTED BY TRUSTEE.

500 (a) If a trustee who conducts a business or other activity deter-
501 mines that it is in the best interest of all the beneficiaries to
502 account separately for the business or activity instead of
503 accounting for it as part of the trust's general accounting records,
504 the trustee may maintain separate accounting records for its trans-
505 actions, whether or not its assets are segregated from other trust
506 assets.

507 b) A trustee who accounts separately for a business or other
508 activity may determine the extent to which its net cash receipts
509 must be retained for working capital, the acquisition or replace-
510 ment of fixed assets, and other reasonably foreseeable needs of
511 the business or activity, and the extent to which the remaining net
512 cash receipts are accounted for as principal or income in the
513 trust's general accounting records. If a trustee sells assets of the
514 business or other activity, other than in the ordinary course of the
515 business or activity, the trustee shall account for the net amount
516 received as principal in the trust's general accounting records to

517 the extent the trustee determines that the amount received is no
518 longer required in the conduct of the business.

519 (c) Activities for which a trustee may maintain separate
520 accounting records include:

521 (1) retail, manufacturing, service, and other traditional business
522 activities;

523 (2) farming;

524 (3) raising and selling livestock and other animals;

525 (4) management of rental properties;

526 (5) extraction of minerals and other natural resources;

527 (6) timber operations; and

528 (7) activities to which Section 414 applies.

529 **PART 2.**

530 **RECEIPTS NOT NORMALLY APPORTIONED.**

531 **SECTION 404. PRINCIPAL RECEIPTS.**

532 A trustee shall allocate to principal:

533 (1) to the extent not allocated to income under this Act, assets
534 received from a transferor during the transferor's lifetime, a dece-
535 dent's estate, a trust with a terminating income interest, or a payer
536 under a contract naming the trust or its trustee as beneficiary;

537 (2) money or other property received from the sale, exchange,
538 liquidation, or change in form of a principal asset, including real-
539 ized profit, subject to this Article;

540 (3) amounts recovered from third parties to reimburse the trust
541 because of disbursements described in Section 502(a)(7) or for
542 other reasons to the extent not based on the loss of income;

543 (4) proceeds of property taken by eminent domain, but a sepa-
544 rate award made for the loss of income with respect to an
545 accounting period during which a current income beneficiary had
546 a mandatory income interest is income;

547 (5) net income received in an accounting period during which
548 there is no beneficiary to whom a trustee may or must distribute
549 income; and

550 (6) other receipts as provided in Part 3.

551 **SECTION 405. RENTAL PROPERTY.**

552 To the extent that a trustee accounts for receipts from rental
553 property pursuant to this section, the trustee shall allocate to

554 income an amount received as rent of real or personal property,
555 including an amount received for cancellation or renewal of a
556 lease. An amount received as a refundable deposit, including a
557 security deposit or a deposit that is to be applied as rent for future
558 periods, must be added to principal and held subject to the terms
559 of the lease and is not available for distribution to a beneficiary
560 until the trustee's contractual obligations have been satisfied with
561 respect to that amount.

562 **SECTION 406. OBLIGATION TO PAY MONEY.**

563 (a) An amount received as interest, whether determined at a
564 fixed, variable, or floating rate, on an obligation to pay money to
565 the trustee, including an amount received as consideration for pre-
566 paying principal, must be allocated to income without any provi-
567 sion for amortization of premium.

568 (b) This section does not apply to an obligation to which
569 Section 409, 410, 411, 412, 414, or 415 applies.

570 **SECTION 407. INSURANCE POLICIES AND SIMILAR**
571 **CONTRACTS.**

572 (a) Except as otherwise provided in subsection (b), a trustee
573 shall allocate to principal the proceeds of a life insurance policy
574 or other contract in which the trust or its trustee is named as bene-
575 ficiary, including a contract that insures the trust or its trustee
576 against loss for damage to, destruction of, or loss of title to a trust
577 asset. The trustee shall allocate dividends on an insurance policy
578 to income if the premiums on the policy are paid from income,
579 and to principal if the premiums are paid from principal.

580 (b) A trustee shall allocate to income proceeds of a contract
581 that insures the trustee against loss of occupancy or other use by
582 an income beneficiary, loss of income, or, subject to Section 403,
583 loss of profits from a business.

584 (c) This section does not apply to a contract to which
585 Section 409 applies.

586

PART 3.

587

RECEIPTS NORMALLY APPORTIONED.

588 **SECTION 408. INSUBSTANTIAL ALLOCATIONS NOT**
589 **REQUIRED.**

590 If a trustee determines that an allocation between principal and
591 income required by Section 409, 410, 411, 412, or 415 is insub-
592 stantial, the trustee may allocate the entire amount to principal
593 unless one of the circumstances described in Section 104(c)
594 applies to the allocation. This power may be exercised by a
595 cotrustee in the circumstances described in Section 104(d) and
596 may be released for the reasons and in the manner described in
597 Section 104(e). An allocation is presumed to be insubstantial if:

598 (1) the amount of the allocation would increase or decrease net
599 income in an accounting period, as determined before the alloca-
600 tion, by less than 10 percent; or

601 (2) the value of the asset producing the receipt for which the
602 allocation would be made is less than 10 percent of the total value
603 of the trust's assets at the beginning of the accounting period.

604 SECTION 409. DEFERRED COMPENSATION, ANNUITIES
605 AND SIMILAR PAYMENTS

606 (a) In this section, "payment" means a payment that a trustee
607 may receive over a fixed number of years or during the life of one
608 or more individuals because of services rendered or property
609 transferred to the payer in exchange for future payments. The
610 term includes a payment made in money or property from the pay-
611 er's general assets or from a separate fund created by the payer,
612 including a private or commercial annuity, an individual retire-
613 ment account, and a pension, profit-sharing, stock-bonus, or
614 stock-ownership plan.

615 (b) To the extent that a payment is characterized as interest or a
616 dividend or a payment made in lieu of interest or a dividend, a
617 trustee shall allocate it to income. The trustee shall allocate to
618 principal the balance of the payment and any other payment
619 received in the same accounting period that is not characterized as
620 interest, a dividend, or an equivalent payment.

621 (c) If no part of a payment is characterized as interest, a divi-
622 dend, or an equivalent payment, and all or part of the payment is
623 required to be made, a trustee shall allocate to income 10 percent
624 of the part that is required to be made during the accounting
625 period and the balance to principal. If no part of a payment is
626 required to be made or the payment received is the entire amount
627 to which the trustee is entitled, the trustee shall allocate the entire

628 payment to principal. For purposes of this subsection, a payment
629 is not “required to be made” to the extent that it is made because
630 the trustee exercises a right of withdrawal.

631 (d) If, to obtain an estate tax marital deduction for a trust, a
632 trustee must allocate more of a payment to income than provided
633 for by this section, the trustee shall allocate to income the addi-
634 tional amount necessary to obtain the marital deduction.

635 (e) This section does not apply to payments to which Section
636 410 applies.

637 SECTION 410. LIQUIDATING ASSET.

638 (a) In this section, “liquidating asset” means an asset whose
639 value will diminish or terminate because the asset is expected to
640 produce receipts for a period of limited duration. The term
641 includes a leasehold, patent, copyright, royalty right, and right to
642 receive payments during a period of more than one year under an
643 arrangement that does not provide for the payment of interest on
644 the unpaid balance. The term does not include a payment subject
645 to Section 409, resources subject to Section 411, timber subject to
646 Section 412, an activity subject to Section 414, an asset subject to
647 Section 415, or any asset for which the trustee establishes a
648 reserve for depreciation under Section 503.

649 (b) A trustee shall allocate to income 10 percent of the receipts
650 from a liquidating asset and the balance to principal.

651 SECTION 411. MINERALS, WATER, AND OTHER NAT-
652 URAL RESOURCES.

653 (a) To the extent that a trustee accounts for receipts from an
654 interest in minerals or other natural resources pursuant to this
655 section, the trustee shall allocate them as follows:

656 (1) If received as nominal delay rental or nominal annual rent
657 on a lease, a receipt must be allocated to income.

658 (2) If received from a production payment, a receipt must be
659 allocated to income if and to the extent that the agreement cre-
660 ating the production payment provides a factor for interest or its
661 equivalent. The balance must be allocated to principal.

662 (3) If an amount received as a royalty, shut-in-well payment,
663 take-or-pay payment, bonus, or delay rental is more than nominal,
664 90 percent must be allocated to principal and the balance to
665 income.

666 (4) If an amount is received from a working interest or any
667 other interest not provided for in paragraph (1), (2), or (3), 90 per-
668 cent of the net amount received must be allocated to principal and
669 the balance to income.

670 (b) An amount received on account of an interest in water that
671 is renewable must be allocated to income. If the water is not
672 renewable, 90 percent of the amount must be allocated to prin-
673 cipal and the balance to income.

674 (c) This Act applies whether or not a decedent or donor was
675 extracting minerals, water, or other natural resources before the
676 interest became subject to the trust.

677 (d) If a trust owns an interest in minerals, water, or other nat-
678 ural resources on [the effective date of this Act], the trustee may
679 allocate receipts from the interest as provided in this Act or in the
680 manner used by the trustee before [the effective date of this Act].
681 If the trust acquires an interest in minerals, water, or other natural
682 resources after [the effective date of this Act], the trustee shall
683 allocate receipts from the interest as provided in this Act.

684 SECTION 412. TIMBER.

685 (a) To the extent that a trustee accounts for receipts from the
686 sale of timber and related products pursuant to this section, the
687 trustee shall allocate the net receipts:

688 (1) to income to the extent that the amount of timber removed
689 from the land does not exceed the rate of growth of the timber
690 during the accounting periods in which a beneficiary has a manda-
691 tory income interest;

692 (2) to principal to the extent that the amount of timber removed
693 from the land exceeds the rate of growth of the timber or the net
694 receipts are from the sale of standing timber;

695 (3) to or between income and principal if the net receipts are
696 from the lease of timberland or from a contract to cut timber from
697 land owned by a trust, by determining the amount of timber
698 removed from the land under the lease or contract and applying
699 the rules in paragraphs (1) and (2); or

700 (4) to principal to the extent that advance payments, bonuses,
701 and other payments are not allocated pursuant to paragraph (1),
702 (2), or (3).

703 (b) In determining net receipts to be allocated pursuant to sub-
704 section (a), a trustee shall deduct and transfer to principal a rea-
705 sonable amount for depletion.

706 (c) This Act applies whether or not a decedent or transferor
707 was harvesting timber from the property before it become subject
708 to the trust.

709 (d) If a trust owns an interest in timberland on [the effective
710 date of this Act], the trustee may allocate net receipts from the
711 sale of timber and related products as provided in this Act or in
712 the manner used by the trustee before [the effective date of this
713 Act]. If the trust acquires an interest in timberland after [the
714 effective date of this Act], the trustee shall allocate net receipts
715 from the sale of timber and related products as provided in this
716 Act.

717 SECTION 413. PROPERTY NOT PRODUCTIVE OF
718 INCOME.

719 (a) If a marital deduction is allowed for all or part of a trust
720 whose assets consist substantially of property that does not pro-
721 vide the spouse with sufficient income from or use of the trust
722 assets, and if the amounts that the trustee transfers from principal
723 to income under Section 104 and distributes to the spouse from
724 principal pursuant to the terms of the trust are insufficient to pro-
725 vide the spouse with the beneficial enjoyment required to obtain
726 the marital deduction, the spouse may require the trustee to make
727 property productive of income, convert property within a reason-
728 able time, or exercise the power conferred by Section 104(a). The
729 trustee may decide which action or combination of actions to take.

730 (b) In cases not governed by subsection (a), proceeds from the
731 sale or other disposition of an asset are principal without regard to
732 the amount of income the asset produces during any accounting
733 period.

734 SECTION 414. DERIVATIVES AND OPTIONS.

735 (a) In this section, “derivative” means a contract or financial
736 instrument or a combination of contracts and financial instruments
737 which gives a trust the right or obligation to participate in some or
738 all changes in the price of a tangible or intangible asset or group
739 of assets, or changes in a rate, an index of prices or rates, or other
740 market indicator for an asset or a group of assets.

741 (b) To the extent that a trustee does not account under
742 Section 403 for transactions in derivatives, the trustee shall allo-
743 cate to principal receipts from and disbursements made in connec-
744 tion with those transactions.

745 (c) If a trustee grants an option to buy property from the trust,
746 whether or not the trust owns the property when the option is
747 granted, grants an option that permits another person to sell prop-
748 erty to the trust, or acquires an option to buy property for the trust
749 or an option to sell an asset owned by the trust, and the trustee or
750 other owner of the asset is required to deliver the asset if the
751 option is exercised, an amount received for granting the option
752 must be allocated to principal. An amount paid to acquire the
753 option must be paid from principal. A gain or loss realized upon
754 the exercise of an option, including an option granted to a settlor
755 of the trust for services rendered, must be allocated to principal.

756 SECTION 415. ASSET-BACKED SECURITIES.

757 (a) In this section, “asset-backed security” means an asset
758 whose value is based upon the right it gives the owner to receive
759 distributions from the proceeds of financial assets that provide
760 collateral for the security. The term includes an asset that gives
761 the owner the right to receive from the collateral financial assets
762 only the interest or other current return or only the proceeds other
763 than interest or current return. The term does not include an asset
764 to which Section 401 or 409 applies.

765 (b) If a trust receives a payment from interest or other current
766 return and from other proceeds of the collateral financial assets,
767 the trustee shall allocate to income the portion of the payment
768 which the payer identifies as being from interest or other current
769 return and shall allocate the balance of the payment to principal.

770 (c) If a trust receives one or more payments in exchange for
771 the trust’s entire interest in an asset-backed security in one
772 accounting period, the trustee shall allocate the payments to prin-
773 cipal. If a payment is one of a series of payments that will result
774 in the liquidation of the trust’s interest in the security over more
775 than one accounting period, the trustee shall allocate 10 percent of
776 the payment to income and the balance to principal.

777 **SUBCHAPTER 5.**
778 **ALLOCATION OF DISBURSEMENTS DURING**
779 **ADMINISTRATION OF TRUST.**

780 **SECTION 501. DISBURSEMENTS FROM INCOME.**

781 A trustee shall make the following disbursements from income
782 to the extent that they are not disbursements to which
783 Section 201(2)(B) or (C) applies:

784 (1) so much of the regular compensation of the trustee and of
785 any person providing investment advisory or custodial services to
786 the trustee, and expenses for accountings, judicial proceedings, or
787 other matters that involve both the income and remainder interests
788 as shall be determined by the trustee;

789 (2) all of the other ordinary expenses incurred in connection
790 with the administration, management, or preservation of trust
791 property and the distribution of income, including interest, ordi-
792 nary repairs, regularly recurring taxes assessed against principal,
793 and expenses of a proceeding or other matter that concerns pri-
794 marily the income interest; and

795 (3) recurring premiums on insurance covering the loss of a
796 principal asset or the loss of income from or use of the asset.

797 **SECTION 502. DISBURSEMENTS FROM PRINCIPAL.**

798 (a) A trustee shall make the following disbursements from
799 principal:

800 (1) such of the disbursements described in Section 501(1) as are
801 not charged to income;

802 (2) all of the trustee's compensation calculated on principal as a
803 fee for acceptance, distribution, or termination, and disbursements
804 made to prepare property for sale;

805 (3) payments on the principal of a trust debt;

806 (4) expenses of a proceeding that concerns primarily principal,
807 including a proceeding to construe the trust or to protect the trust
808 or its property;

809 (5) premiums paid on a policy of insurance not described in
810 Section 501(3) of which the trust is the owner and beneficiary;

811 (6) estate, inheritance, and other transfer taxes, including penal-
812 ties, apportioned to the trust; and

813 (7) disbursements related to environmental matters, including
814 reclamation, assessing environmental conditions, remedying and

815 removing environmental contamination, monitoring remedial
816 activities and the release of substances, preventing future releases
817 of substances, collecting amounts from persons liable or poten-
818 tially liable for the costs of those activities, penalties imposed
819 under environmental laws or regulations and other payments made
820 to comply with those laws or regulations, statutory or common
821 law claims by third parties, and defending claims based on envi-
822 ronmental matters.

823 (b) If a principal asset is encumbered with an obligation that
824 requires income from that asset to be paid directly to the creditor,
825 the trustee shall transfer from principal to income an amount equal
826 to the income paid to the creditor in reduction of the principal bal-
827 ance of the obligation.

828 SECTION 503. TRANSFERS FROM INCOME TO PRIN-
829 CIPAL FOR DEPRECIATION.

830 (a) In this section, “depreciation” means a reduction in value
831 due to wear, tear, decay, corrosion, or gradual obsolescence of a
832 fixed asset having a useful life of more than one year.

833 (b) A trustee may transfer to principal a reasonable amount of
834 the net cash receipts from a principal asset that is subject to depre-
835 ciation, but may not transfer any amount for depreciation:

836 (1) of that portion of real property used or available for use by a
837 beneficiary as a residence or of tangible personal property held or
838 made available for the personal use or enjoyment of a beneficiary;

839 (2) during the administration of a decedent’s estate; or

840 (3) under this section if the trustee is accounting under Section
841 403 for the business or activity in which the asset is used.

842 (c) An amount transferred to principal need not be held as a
843 separate fund.

844 SECTION 504. TRANSFERS FROM INCOME TO REIM-
845 BURSE PRINCIPAL.

846 If an amount chargeable to income is unusually large, a trustee
847 may pay all or any part of such amount from principal and shall
848 reimburse principal by transfers from income over a reasonable
849 period of time.

850 SECTION 505. INCOME TAXES.

851 (a) A tax required to be paid by a trustee based on receipts
852 allocated to income must be paid from income.

853 (b) A tax required to be paid by a trustee based on receipts
854 allocated to principal must be paid from principal, even if the tax
855 is called an income tax by the taxing authority.

856 (c) A tax required to be paid by a trustee on the trust's share of
857 an entity's taxable income must be paid proportionately:

858 (1) from income to the extent that receipts from the entity are
859 allocated to income; and

860 (2) from principal to the extent that:

861 (A) receipts from the entity are allocated to principal; and

862 (B) the trust's share of the entity's taxable income exceeds the
863 total receipts described in paragraphs (1) and (2)(A).

864 (d) For purposes of this section, receipts allocated to principal
865 or income must be reduced by the amount distributed to a benefi-
866 ciary from principal or income for which the trust receives a
deduction in calculating the tax.

867

SUBCHAPTER 6.

868

MISCELLANEOUS PROVISIONS.

869 SECTION 601. SEVERABILITY CLAUSE.

870 If any provision of this Act or its application to any person or
871 circumstance is held invalid, the invalidity does not affect other
872 provisions or applications of this Act which can be given effect
873 without the invalid provision or application, and to this end the
874 provisions of this Act are severable.

875 SECTION 602. REPEAL. The following statutes are repealed:

876 G.L. c. 197, 27, c. 203, 21A, 21B, 22, 24A, 24B.

877 SECTION 603. EFFECTIVE DATE. This Act takes effect
878 on

879 SECTION 604. APPLICATION TO EXISTING TRUSTS
880 AND ESTATES.

881 This Act applies to every trust or decedent's estate existing on
882 the effective date of this Act except as otherwise expressly pro-
883 vided in the will or terms of the trust or in this Act.